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No. 685

In the Supreme Court of the United States

OCTOBER TERM, 1958

EZRA ROYCE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Court of Appeals (III R. 633–643; Pet. 1a–13a) is not yet officially reported. The memorandum findings of fact and opinion of the Tax Court (I R. 216–296) are not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1958. (III R. 644; Pet. 13a.) The petition for certiorari was filed on February 5, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether taxpayer's wife Dora was a bona fide member of the Yellow Cab Company partnerships of Portland and Seattle.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof; or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1952 ed., Sec. 181.)

STATEMENT

There were three family partnership problems involved in the instant case before the Tax Court and the Court of Appeals. The first involved the validity of a so-called partnership between the taxpayer, Ezra

Royce, and his wife, Dora, in the Yellow Cab Company of Portland, the second involved the same parties in the Yellow Cab Company of Seattle, and the third involved the so-called partnership interest of the Eunice Royce Trust in the Yellow Cab Company of Seattle.[1] The Tax Court and the Court of Appeals for the Ninth Circuit both affirmed the Commissioner's determination that all income resulting from the purported interests of Dora and the Eunice Royce Trust was taxable to Ezra Royce. The taxpayer, Ezra Royce, does not now question the correctness of the determination that the Eunice Royce Trust was not a bona fide member of the Seattle partnership, but rather directs his petition solely to the validity of his wife's interests in both Yellow Cab Company partnerships. The taxable years involved are 1944 through 1947. (I R. 59–103.) The pertinent facts, as found by the Tax Court in regard to these issues (I R. 263–278), may be summarized as follows:

Prior to August 1, 1942, Yellow Cab Incorporated was an Oregon corporation engaged in the operation of a taxicab business in Portland, Oregon. On August 1, 1942, the corporation was liquidated and dissolved. On the same date, a partnership under the name of Yellow Cab Company (hereinafter called Portland partnership) was formed to operate the business formerly conducted by the corporation. One day prior to the dissolution of the corporation, Ezra Royce transferred 14,000 shares of the corporate stock to his wife, Dora F. Royce. This transfer repre-

[1] Eunice Royce is the daughter of Ezra and Dora Royce.

sented slightly less than half of the shares of stock formerly held by him. The transfer of the stock to Dora was made in anticipation of the planned dissolution of the corporation and the simultaneous formation of the partnership, and the purpose of the transfer was to qualify Dora for admission to the partnership. (I R. 263.)

Under the Portland partnership agreement, Ezra's interest was 26.1575 percent and Dora's interest was 23.06 percent.[2] Profits and losses were to be borne in proportion to partnership interests. The agreement provided that each of the partners was to have an equal voice in the control and operation of the business. (I R. 265.)

Prior to April 20, 1944, Yellow Cab Company of Seattle was a Washington corporation engaged in the operation of a taxicab business in Seattle, Washington. Ezra Royce owned 1,402½ shares of the 5,500 shares which were issued and outstanding. On May 1, 1944, the Yellow Cab Company was liquidated and dissolved. On the same date, May 1, 1944, a partnership of the same name (hereinafter called Seattle partnership) was formed to operate the business formerly conducted by the corporation. (I R. 266–267.)

On April 20, 1944, immediately prior to the dissolution of the Seattle corporation, Ezra Royce transferred 402½ shares of the corporate stock to his wife, Dora. At the same time, he transferred 700 shares of the stock to himself as trustee for his minor daughter,

[2] The remaining interests were held by Ezra's brother, B. Royce, 26.1575 percent, his wife Isabelle, 23.06 percent, and two employees, 1.565 percent. (I R. 265.)

Eunice Royce, then fourteen or fifteen years of age. He retained 300 shares of stock for himself. The transfers of the stock to Dora F. Royce, and to himself as trustee for Eunice Royce, were made in anticipation of the planned dissolution of the corporation and the simultaneous formation of the partnership, and the purpose of the transfers of stock was to qualify Dora and the trust for admission to the partnership. Gift tax returns were filed covering the gifts of stock in the Seattle corporation to both Dora and the trust. (I R. 267.)

The Seattle partnership agreement provided that profits and losses were to be borne in proportion to partnership interests (I R. 269–270); and decisions on partnership matters were to be made by a majority in interest of the partners. (I R. 269.)

Both partnerships kept their books and prepared their tax returns on an accrual basis of accounting during all the years in question. Ezra Royce was the most active partner in the Portland partnership. He made the important decisions as well as the day-to-day decisions involved in the operation of the business. He was in charge of the office, and his supervision and management included the shop and garage personnel. Dora devoted some time to checking the drivers and cars at the stands, boats, depots and any place in Portland where the cabs came frequently to pick up or discharge passengers. She also checked the appearance and condition of uniforms, cleanliness, number of passengers carried and made written reports on these matters to the office. On Schedule I of the partnership returns filed by the Portland partner-

ship for the years 1946 through 1949, no percentage of time devoted to the business by Dora is indicated. Duties similar to those rendered by Dora for the Portland partnership were rendered by an employee of the Seattle partnership for that firm. (I R. 271–272.)

During the years 1944 through 1947, Dora withdrew $171,434.76 and Ezra $201,479.93 from the Portland partnership. (I R. 272.) The withdrawals from the Seattle partnership were as follows (I R. 272–273):

Year	*Dora F. Royce*	*E. Royce*
1945	$41,622.53	$30,994.97
1946	19,662.53	14,644.97
1947	12,342.53	9,194.97
1948	12,342.53	9,194.97
1949	5,022.53	3,744.97
Total	90,992.65	67,774.85

At the end of 1947, the Portland partnership's accumulated earnings distributable to Dora exceeded her withdrawals by $35,434.76, and those distributable to Ezra exceeded his withdrawals by $38,395.26. At the end of 1949, the Seattle partnership's accumulated earnings distributable to Dora and Ezra exceeded their withdrawals by the amounts of $18,733.16 and $14,008.75, respectively. (I R. 273.)

The foregoing withdrawals by Dora were in the form of checks made payable to her. Checks so issued to her by the Portland partnership in 1944, in the aggregate amount of $48,777.75, were endorsed in blank. Another check issued to her by the Portland partnership on February 23, 1945, in the amount of $11,530, was also endorsed in blank by Dora and paid by the drawee, the United States National Bank, on April 3, 1945. All other checks issued to Dora by the Portland partnership and all those issued to her by

the Seattle partnership, totaling $170,479.59, were endorsed in blank both by her and by Ezra Royce. (I R. 273.)

A substantial portion of the partnership earnings distributed to Dora by both partnerships was expended in payment of state and federal taxes. The amounts so expended by Dora for federal taxes for the years 1944 to 1947 were as follows (I R. 274):

Year	*Amount*
1944	$29,783.72
1945	57,315.46
1946	51,721.22
1947	29,454.14
Total	168,284.54

A portion of the distributions made to Dora by both partnerships was expended by her for such items as (I R. 275):

Item	*Approximate cost*
2 Fur Coats	$1,850
2 Chrysler Autos	8,000
Plymouth and Cadillac	Unknown
Exercycle	350
Silverware	1,800
Lace Cloth	400
Government Bonds	7,000
Missouri-Pacific Stock	4,500
House Improvements	18,000

In addition to the above amounts, a total of approximately $70,000 was loaned to Ezra to be invested in Alder Gold-Copper Company, a company in which, in 1947 and years subsequent thereto, he was interested. Other amounts were given to Ezra to reimburse him for payments he had made for Dora. (I R. 275.)

After trial, the Tax Court, on the basis of considerable oral testimony, held that Dora was not a bona

fide member of the Portland and Seattle partnerships during the taxable years for income tax purposes, and that the Commissioner had properly included in the income of Ezra the partnership profits reported by her. (I R. 275.)

In affirming these holdings, the Court of Appeals held that these findings of fact by the Tax Court were correct and would not be disturbed on appeal. (III R. 641–643; Pet. 10a–13a.)

ARGUMENT

This case presents no more than a question of fact. The court below correctly affirmed the Tax Court's determination, there is no conflict with the decision of another circuit, and no occasion for further review.

1. This Court, in *Commissioner* v. *Culbertson*, 337 U.S. 733, 742, set forth the ground rules applicable to taxation of family partnerships. Thus, the test is whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise. The Tax Court, after carefully studying all of the facts involved in this case in the light of such criteria, came to the conclusion (I R. 278) that "the parties in-

volved at no time really and truly intended Dora to be a bona fide partner in carrying on the business of the Portland and Seattle partnerships." Upon review, the Ninth Circuit properly held that this factual determination was correct. (III R. 642–643; Pet. 11a–13a.)

The situation here is one where a purported partner has not contributed vital services, has not participated in the management and control of the business, and has not contributed "original capital" to the partnership. While these factors do not as a matter of law under the *Culbertson* case suffice to provide an automatic formula for the objective determination of family partnership cases, it is recognized that they do have "the effect of placing a heavy burden on the taxpayer to show the bona fide intent of the parties to join together as partners." *Commissioner* v. *Culbertson, supra,* p. 744; *Wisdom* v. *United States,* 205 F. 2d 30 C.A. 9th); *Feldman* v. *Commissioner,* 186 F. 2d 87, 90–91 (C.A. 4th). The circumstances attendant to Dora's purported interests in both of these partnerships show that prior to the formation of the partnerships her husband, the taxpayer, was a stockholder in the Yellow Cab corporations of Portland and Seattle. In both instances the taxpayer gave Dora stock of the corporations pursuant to and in anticipation of the plan to dissolve the corporations and transfer the assets to the partnerships. These stock transfers were made contingent upon her joining the partnerships and for the sole purpose of qualifying her for admission thereto. (I R. 277; II R. 428–429.) After the corporations were dissolved and the assets trans-

ferred to the partnerships, the conduct of the businesses remained unchanged, the same persons continued to operate and control them as had done so before the formation of the partnerships. The taxpayer failed to convince the courts below that there were any business purposes for taking Dora into the partnership,[3] and this Court has held that to comprise a valid partnership for tax purposes the parties must intend to join together in good faith "and acting with a business purpose." *Commissioner* v. *Culbertson, supra,* p. 742. Of course, the adoption of a family partnership for the sole purpose of splitting income is not acting with a business purpose, for "keeping down taxes is not of itself 'business'." *Slifka* v. *Commissioner,* 182 F. 2d 345, 346 (C.A. 2d). Accord: *Smith* v. *Westover,* 237 F. 2d 201 (C.A. 9th); *Parker* v. *Westover,* 248 F. 2d 490 (C.A. 9th).

Dora did not exercise any real dominion or control over her so-called investments in the partnerships and did not "through that control influence[s] the conduct of the partnership and the disposition of its income." *Commissioner* v. *Culbertson, supra,* p. 747. While both she and her husband testified that she participated in the management and control of both partnerships, the Tax Court was not bound to accept this testimony by interested witnesses. This is particularly so when one considers the statements in

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[3] Compare *Jones* v. *Baker,* 189 F. 2d 842 (C.A. 10th), where the taxpayer gave his wife a one-half interest in his holdings because he was in the armed services, about to be sent overseas, and desired to have his affairs in order so that his wife would be provided for should he not return.

certain of the partnership returns signed and sworn to by taxpayer indicating that Dora performed no services for the partnerships. (I R. 277.) Another important criterion in determining whether or not Dora was a bona fide partner is whether she "is free to, and does, enjoy the fruits of the partnership." *Commissioner* v. *Culbertson*, *supra*, p. 747; *Sellers* v. *Commissioner*, 218 F. 2d 380 (C.A. 9th). The facts show clearly that taxpayer controlled the partnership earnings distributed to his wife. As the Ninth Circuit stated (III R. 642; Pet. 11a):

> Her expenditures were for family purposes. Besides, she "loaned" a great part of the earnings of this business, ostensibly allocated to her, to her husband to invest in another venture.

Thus, the principles set forth by this Court in *Commissioner* v. *Tower*, 327 U.S. 280; *Lusthaus* v. *Commissioner*, 327 U.S. 293; *Lucas* v. *Earl*, 281 U.S. 111; *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Horst*, 311 U.S. 112, and reaffirmed in *Culbertson*, are applicable. Here the purported gift, whether or not technically complete, made no substantial change in the economic relations of the Royce family. The result of the transactions was no more than a paper reallocation of income among family members, of no effect for purposes of federal taxation. The status quo of the family vis-a-vis the income was retained.

2. Analysis of taxpayer's petition makes it apparent that he is attempting to urge upon this Court the very type of mechanical determination of the family partnership question which was condemned in *Culbertson*. Thus, in essence, his argument is that

because Dora performed certain services[4] in connection with the Portland partnership, because neither she nor the taxpayer performed any services in connection with the Seattle partnership, because the gifts of capital to Dora from taxpayer might be valid under state law, she must be considered a bona fide partner for tax purposes in both partnerships. But these factors, like all others, can do no more than throw light upon the true intent of the parties—whether in good faith and acting with a business purpose they intended to join together in the present conduct of the enterprise. The Tax Court, applying the proper criteria, determined this question of fact, and the Court of Appeals correctly affirmed this decision since it was not clearly erroneous.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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[4] These services, upon which taxpayer places great importance, consisted of checking cabs and drivers, and were of such a nature that they could be performed while shopping downtown or driving along the street. The Tax Court termed them "relatively inconsequential." (I R. 277.)

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